

**DEPARTMENT OF STATE REVENUE**

**LETTER OF FINDINGS NUMBER: 96-0553 ITC**

**Gross Income Tax**

**For Tax Period: 1990 Through 1992**

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

**ISSUE**

**I. Gross Income Tax - Receipts on Behalf of Franchisees**

**Authority:** IC 6-2.1-1-10; 45 I.A.C. 1-1-54

Taxpayer protests the imposition of gross income tax on the receipts on behalf of the franchisees.

**A. Royalty Fee**

**Authority:** IC 6-2.1-2-2; Indiana Dept. Of St. Rev. v. Convenient Industries, 299 N.E.2d 641 (1973); 45 I.A.C. 1-1-51

Taxpayer protests the imposition of gross income tax on fees received as royalties for use of intangibles.

**B. Administrative Fee**

**Authority:** 45 I.A.C. 1-1-48; Indiana Dept. Of St. Rev. v. Convenient Industries, 299 N.E.2d 641 (1973)

Taxpayer protests the imposition of gross income tax on fees received for administrative services performed outside Indiana.

### **STATEMENT OF FACTS**

Taxpayer is in the business of providing temporary employee services. Taxpayer has its own operations as well as franchisees in the State of Indiana. The franchisees contractually agree to conform their operations to the taxpayer's system and continue to pay the taxpayer a royalty and administrative fee. The franchisees are independent business entities responsible for the management of individual offices. Taxpayer provides guidelines, which the franchisees are obligated to follow, regarding location, appearance of offices, hours of operation, etc. Taxpayer provides two types of service to franchisees. First, taxpayer provides general guidance in the implementation of the taxpayer's system (through occasional visits by District Managers). Second, taxpayer furnishes franchisees with billing, collection and payroll (administrative) services.

The temporary employees are employees of the taxpayer for the purpose of payroll. The franchisees make all hiring and firing decisions and determine the employees' rates of pay. The taxpayer collects all receivables (resulting from the temporary work) and issues paychecks to the temporary employees.

At the end of an accounting period, taxpayer remits to franchisees that portion of the billings for the period that represents the franchisees' projected gross profits (defined as the gross billings less payroll expenses for the temporary employees and the administrative fee and royalty due to taxpayer). Taxpayer also retains a reserve for bad debts. Additional facts will be presented below, as necessary.

#### **I. Gross Income Tax - Gross Receipts on Behalf of Franchisees**

### **DISCUSSION**

Taxpayer performs the services of collecting all receipts and paying the temporary employees. Pursuant to the franchise agreements executed between the taxpayer and franchisees, the temporary employees are the employees of the taxpayer and not the franchisees. As such, the auditor found gross receipts taxpayer received on behalf of the franchisees were for the benefit of the taxpayer.

Taxpayer claims the income received was not income attributable to the taxpayer as it was received in an agency capacity. Taxpayer argues that as it was collecting the receipts on behalf of the Indiana franchisees, the gross receipts should be attributable to the Indiana franchisees and not to the taxpayer. Taxpayer collects all the receipts, pays the temporary employees, and then retains for itself the administrative and royalty fees due, as set forth in the contractual agreement with the franchisees.

As stated in 45 I.A.C. 1-1-54, taxpayers are not subject to tax on gross income they receive in an agent capacity if they meet two requirements. The first is that the taxpayer must be a true agent with a manifestation of consent from one party to the taxpayer to act on his behalf. The second is that the taxpayer must not have any right, title or interest in the money received as an agent.

Taxpayer has proven to the Department's satisfaction that there was both agency and no interest in the money received as an agent which passed through to the franchisees. Pursuant to the franchise agreements, the franchisees expressed their consent for the taxpayer to collect the receipts on their behalf. The receipts the taxpayer retained (i.e., employee payroll, administrative and royalty fees) did not pass through to the franchisees and the taxpayer had an interest in those receivables.

### **FINDING**

Taxpayer's protest is sustained in part and denied in part. The receivables collected by the taxpayer which were passed through to the franchisees were not taxable. The receivables retained by the taxpayer for payment of employees' wages were taxable. The receivables retained by the taxpayer for administrative and royalty fees are addressed separately below.

#### **A. Royalty Fee**

### **DISCUSSION**

As stated above, the taxpayer collects all receivables resulting from the temporary work and retains, for itself, the royalty fees due from the franchisees. The auditor assessed gross income tax on the taxpayer's receipt of royalty payments pursuant to IC 6-2.1-2-2(a), which reads in pertinent part:

(a) An income tax, known as the gross income tax, is imposed upon the receipt of:

- (1) the entire taxable gross income of a taxpayer who is a resident or a domiciliary of Indiana; and
- (2) the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana...

Taxpayer is a Georgia corporation, domiciled in the State of Georgia. Taxpayer claims the royalty fee is a payment from the franchisees to the taxpayer for the use of the taxpayer's name, trademark and the taxpayer system. Taxpayer claims the situs of the intangible properties, which are licensed to the franchisees and for which the royalty payments are made, are located in Georgia. As such, taxpayer argues the income derived from the intangibles is not attributable to activities within the state of Indiana but to the state of Georgia. Taxpayer cites Indiana Dept. Of St. Rev. v. Convenient Industries, 299 N.E.2d 641 (1973). In Convenient Industries, the Court found service and advertising fees paid by franchisees in Indiana to a Kentucky corporation were not sufficient to subject the Kentucky corporation to the Indiana Gross Income Tax even though the Kentucky corporation had minimal activities within Indiana.

The Department does not find Convenient Industries conclusive in the case of intangible royalty fees.

Pursuant to 45 I.A.C. 1-1-51:

...If the intangible or the income derived therefrom forms an integral part of a business regularly conducted at a situs in Indiana, the total gross income derived from the sale, assignment, transfer or exchange of the rights comprising the intangible property, or from interest, finance charges, dividends or other earnings upon the intangibles of any kind, or from any other source arising from the ownership to another will be required to be reported for taxation...

The Department finds there is situs of the intangible in Indiana. The owner of the intangible, the taxpayer, is domiciled in Georgia, however, the intangible is being licensed for use in Indiana and income is earned on this use.

### **FINDING**

Taxpayer's protest is denied.

### **B. Administrative Fee**

### **DISCUSSION**

Again, as stated above, the taxpayer collects all receivables resulting from the temporary work and retains, for itself, the administrative fees due from the franchisees. The administrative services include billing, collection, and payroll services. Taxpayer claims these services are performed primarily in Georgia and should not be subject to Indiana gross income tax.

Pursuant to 45 I.A.C. 1-1-48(4):

Out-of-state franchisor with Indiana franchisees: the franchisor is taxable upon that part of his fees and income derived from activities in this state, . . . more than a minimal or incidental amount of which takes place in the state.

Taxpayer argues that as it performs these administrative services in Georgia, the fees received from these services is not attributable to Indiana.

Convenient Industries is applicable here. In that case, the Court stated "gross income of a non-resident must be derived from activities within the state. If the activities giving rise to the income sought to be taxed do not occur within Indiana, then the tax may not be levied." Convenient Industries at 645. The Court found only incidental matters were performed within Indiana but that the activities contemplated by the statute must be more than minimal. *Id.*

02960553.LOF

PAGE #5

**FINDING**

Taxpayer's protest is sustained.